

STATE TREASURER'S 2003 POLICY GOALS AND INITIATIVES

POLICY GOALS

California State Treasurer Phil Angelides was sworn into office on January 4, 1999 and began his second term on January 6, 2003. As the State's chief investment officer, his key goals have been to protect taxpayer funds; cost-effectively finance the schools and other infrastructure that California needs to succeed in the 21st Century; and increase investments in California's communities.

What follows is a brief summary of the major 2003 policy initiatives that the Treasurer undertook in pursuit of these goals. The ***State Treasurer's Policy Goals and Initiatives*** for the years 1999-2002, as well as this document, can be found online at www.treasurer.ca.gov.

PROTECTING TAXPAYER DOLLARS

CONTINUED LEADERSHIP ON CORPORATE REFORM

Building on the *Power of the Purse* initiative he launched in 2002, Treasurer Angelides continued fighting in 2003 for meaningful corporate reforms to protect taxpayers, pensioners and their families; restore integrity to and renew investor confidence in the financial markets; and foster sustained economic prosperity. (The Treasurer's 2002 report, *The Power of the Purse: How Investors Can Restore Integrity to Our Financial Markets*, and a chronicle of the Treasurer's actions on corporate reform are available online at http://www.treasurer.ca.gov/Corporate_Reform.)

Here are some of the most significant actions undertaken by the Treasurer in 2003 to advance the cause of corporate reform:

▪ **Reforming the New York Stock Exchange**

On September 16, 2003, Treasurer Angelides became the first public official in the nation to call for the resignation of New York Stock Exchange (NYSE) chairman and CEO Dick Grasso, following revelations regarding Grasso's excessive pay package and the process by which it was negotiated. The Treasurer – joined by Sean Harrigan, President of the Board of Administration of the California Public Employees' Retirement System (CalPERS), and Jack Ehnes, CEO of the California State Teachers' Retirement System (CalSTRS) – said that Grasso's \$188 million compensation package set back critical efforts to restore the public's faith in our financial system, and threatened the

Exchange's ability to provide critical leadership in the area of corporate reform. The call for Grasso's resignation from Treasurer Angelides, Mr. Harrigan and Mr. Ehnes set off a national wave of public and investment official demands that Grasso step down. Mr. Grasso resigned as chairman and CEO of the Exchange on September 17, 2003.

Following Grasso's resignation, Treasurer Angelides led a delegation of state treasurers, chief investment officers and public pension fund officials to New York, where they met with members of the NYSE Board of Directors to demand fundamental governance reforms at the Exchange, a reduction in Grasso's outsized compensation, and a thorough, independent investigation of the NYSE's operations and governance, including the events which led to Mr. Grasso's pay package.

The coalition of state treasurers, comptrollers and others was successful in prompting the NYSE to conduct such an independent investigation and to undertake significant governance reforms, including a separation of the Exchange's chairman and CEO positions, and the election of independent board members. The results of the NYSE's investigation has prompted an inquiry by the SEC and by New York Attorney General Eliot Spitzer into the Grasso pay matter.

- **Expatriates**

Treasurer Angelides has been a national leader in fighting to end the practice of corporate expatriation, a process by which companies move their place of incorporation – in name only – to tax havens like Bermuda and the Cayman Islands to avoid paying their fair share of taxes and weaken shareholder rights. In a continuing effort to curb the trend of corporate expatriation and address the detrimental effects of this practice on investors and taxpayers, the Treasurer took the following actions in 2003:

“Come Home to America” Campaign: Treasurer Angelides joined with CalPERS, CalSTRS and other institutional investors in a nationwide fight against corporate expatriation, calling on Tyco International and other runaway companies to repatriate back to the United States.

The “Come Home to America” campaign scored significant victories during 2003. More than 26.4 percent of Tyco's shareholders voted on March 6 to bring Tyco back to the United States from Bermuda; on March 25, McDermott International agreed to work toward reincorporating from Panama back to the U.S.; and on March 30, 2003, a stunning 41.4 percent of Ingersoll-Rand shareholders voted to reincorporate back in the U.S. Given the many obstacles to mounting and running insurgent shareholder campaigns, each of these votes represented a significant milestone in the effort to curb the practice of corporate expatriation.

The California Taxpayer and Shareholder Protection Act of 2003:

Treasurer Angelides sponsored Senate Bill 640 (Burton), signed by Governor Gray Davis on October 2, 2003, which prohibits the State of California from contracting with any publicly held U.S. corporate expatriate companies.

Closing Tax Loopholes for Expatriates: The Treasurer also sponsored SB 1067 (Speier), which would close loopholes that allow expatriates to annually avoid an estimated \$10 million in California taxes. The bill fell only one vote short of the two-thirds vote required for State Senate passage. The Treasurer is sponsoring a similar bill, AB 2584 (Chu), in 2004.

▪ **Investment Protection Standards**

In the wake of the May 2003 landmark settlement of enforcement actions by New York State Attorney General Eliot Spitzer and the SEC against 10 large investment banks, Treasurer Angelides imposed tough new requirements on all investment banks that want to do business with the State. The action made California the first state in the nation to apply and expand the reforms of the Wall Street settlement to each firm eligible to handle issuance of State bonds and each broker/dealer firm that does business with the State's investment fund. These tough new standards replaced the voluntary Investment Protection Principles the Treasurer adopted in July 2002 for firms wishing to do business with the State. The new Standards require, among other things, that financial institutions separate entirely their research and investment banking practices, including physical separation and completely separate lines of command, legal and compliance staffs and budgeting. Firms are also required to create "firewalls" between research and investment banking reasonably designed to prohibit improper communications between the two.

By March 9, 2004, 41 of 44 firms to which the standards applied had certified their compliance with the Treasurer's Standards. The three firms that had not confirmed compliance by March 9 met a March 31 deadline for doing so; failure to comply would have meant suspension from doing business with the State.

At the Treasurer's urging, CalSTRS adopted the Treasurer's Investment Protection Standards for the investment banks that do business with the pension fund on July 9, 2003, and CalPERS adopted them on August 18, 2003.

▪ **Equity Compensation Standards**

In April 2003, Treasurer Angelides proposed new standards for equity compensation – including stock options – for the largest 1,000 companies in which CalPERS and CalSTRS invest, in an effort to curb excesses in executive compensation that undermine confidence in the nation's financial markets, and to encourage corporations to offer broad-based equity compensation plans for all their employees – not just top executives.

Under the Treasurer's standards, approved by CalPERS on June 16 and CalSTRS on July 9, the pension funds will vote to support equity compensation plans if the plans award less than 5 percent of the total compensation to the top five executives of the company, and if the plans grant less than 25 percent of the total to executives or directors of the company. In addition, the plans must provide vesting schedules of four years

or longer. The standards were modeled after equity compensation plans at Intel Corp. and other “best-practices” companies. Many independent experts say that such broad-based approaches result in greater long-term corporate value, increased productivity, and higher, sustained yields to investors.

■ **Office of Pension Protection and Market Reform**

In March 2003, Treasurer Angelides, joined by New York State Attorney General Eliot Spitzer, announced a proposal for a new California Office of Pension Protection and Market Reform, a joint effort of CalPERS and CalSTRS, to strengthen California’s clout in advancing an agenda of corporate reform. The proposed CalPERS-CalSTRS alliance would help protect state pension fund members and their assets by seeking redress and restitution for harm done and losses caused by corporate malfeasance; deterring future misconduct; and pursuing the corporate and financial market reforms necessary to return and maintain integrity in the marketplace.

By year’s end, both CalPERS and CalSTRS were working cooperatively toward the goals identified by the Treasurer for the new Office. CalPERS and CalSTRS each appointed ad hoc committees to further refine and make recommendations on the Treasurer’s plan. Final action by CalSTRS and CalPERS on a coordinated corporate reform effort is expected in the spring of 2004.

■ **Pressed SEC to Complete Shareholder Reforms**

In June 2003, Treasurer Angelides, joined by the chief investment officers of six other states, called on SEC Chairman William Donaldson to move quickly to complete reforms on issues crucial to the protection of shareholders.

The group issued a “progress report” on the SEC under Donaldson, and called on the chairman to complete reforms to democratize “management-controlled” corporate elections; to halt brokers’ ability to stuff corporate ballots for management; and to stop corporations from co-opting accounting firms with lucrative tax consulting contracts.

In October, the Treasurer and 10 other state and local pension fund officials called on the SEC to ensure proxy access to shareholders. They argued that the SEC’s proposed rules for proxy access contained excessively restrictive “triggers” that would effectively block shareholders from using proxy access to nominate director candidates and challenge ineffective boards.

■ **Terminated Contracts with Putnam Investments**

On November 4, Treasurer Angelides called on CalPERS and CalSTRS to terminate their combined \$1.5 billion relationships with Putnam Investments, a company embroiled in controversy over its corporate practices, including allegedly engaging in unlawful “market timing” practices. CalPERS’ Investment Committee voted to terminate CalPERS’ \$1.2 billion contract with Putnam on November 17, and CalSTRS voted to terminate its \$312 million contract with Putnam on December 4.

▪ **Called for End to Unocal's Operations in Burma**

In September 2003, Treasurer Angelides, joined by New York State Comptroller Alan Hevesi, CalPERS board president Sean Harrigan, and other pension fund representatives, called on Unocal to pull its operations out of Burma (also known as Myanmar) or fully justify to shareholders why Unocal should continue to operate in that country, where American companies are now banned by the United States government from making new investments. Additionally, the group demanded proof that Unocal had begun to implement labor and human rights principles that the company had agreed to earlier. In a meeting, with Unocal executives at the company's headquarters in El Segundo, California, Angelides, Hevesi and the others expressed concern that the company's investment in Burma exposed the company and its shareholders to significant potential liabilities stemming from alleged human rights abuses, and to reputational damage from operating in a company sanctioned by the world community.

CALLED FOR ACTIONS TO REDUCE RISKS POSED TO INVESTORS FROM CLIMATE CHANGE

Treasurer Angelides, joined by other treasurers, public financial officials, and corporate and investment lenders from around the world, met at the United Nations in November 2003 to demand tough actions by the SEC, corporate boards, and Wall street firms to reduce the long-term threats that climate change pose to investors. The group also formed an "Investor Network on Climate Risk" to continue joint actions on the issue.

The Network's actions come at a time when the financial community is increasingly recognizing investment risks related to climate change. Insurer Swiss Re has recently warned that global warming presents a potential "catastrophe," with the economic costs of natural disasters potentially doubling over the next 10 years, and costs to insurers rising by \$30 billion-\$40 billion annually in that time period. In addition, the German insurance company Munich Re has estimated that the water industry alone could face nearly \$47 billion in additional costs within the next 50 years due to climate change.

(For more information on the efforts of the Investor Network, visit <http://www.ceres.org>. Text of the Treasurer's speech to the UN summit is available online at <http://www.treasurer.ca.gov/news/speeches/speeches.htm>.)

SPONSORED LANDMARK LEGISLATION TO IMPROVE FUEL EFFICIENCY OF STATE'S FLEET

The Treasurer sponsored landmark legislation, SB 552 (Burton), signed by Governor Davis on October 8, 2003, which set tough new fuel-efficiency standards for the lease and purchase of vehicles for the State's fleet, currently comprised of 73,000 state-owned vehicles.

The bill also implements recommendations made by the California Energy Commission, the Department of General Services and the California Air Resources Board to lessen pollution and garner increased fuel efficiency from the State's vehicle pool, including increased use of alternative fuels and bi-fuel

vehicles, increased purchase of hybrid and other fuel-efficient vehicles, and limiting state agencies from purchasing or leasing Sport Utility Vehicles (SUVs) where other, less expensive vehicles are appropriate. The bill is expected to result in substantial savings to taxpayers. The Treasurer's Office estimates, for example, that if the State's purchases of SUVs were reduced by 75 percent, with less expensive passenger vehicles being purchased instead, the State would save \$14.3 million over a five-year period in reduced purchase and fuel costs.

OPPOSED COSTLY DEFICIT FINANCING

Treasurer Angelides led a statewide effort opposing Governor Schwarzenegger's legislation, introduced in late 2003, which proposed costly deficit financing, which the Treasurer noted would burden the State's future generations with billions of dollars in debt, while doing nothing to close the State's structural budget gap. The Governor's original proposal called for authorization of up to \$17 billion in deficit borrowing, resulting in total principal and interest costs to taxpayers of \$35 billion over 30 years. As a result of the efforts of Treasurer Angelides and legislative leaders, the bond measure passed by the Legislature was smaller, shorter in term, and will cost taxpayers \$16 billion less than the Governor's initially proposed borrowing plan.

TAXPAYER FUNDS INVESTED WITH SOLID EARNINGS

In 2003, the Treasurer's Office earned a solid return of 1.74 percent for the Pooled Money Investment Account (PMIA), which the Office oversees. The PMIA, which had approximately \$54 billion in assets as of December 31, 2003, is comprised of the short-term investment funds of State government and more than 2,700 local jurisdictions. PMIA returns in 2003 were bolstered by the Treasurer's decision to purchase, since January 1999, \$1.7 billion of California-only, Community Reinvestment Act (CRA) mortgages and teachers' home mortgages, which earned 5.88 percent during the year.

Within the PMIA is the Local Agency Investment Fund (LAIF), a voluntary program that allows participating cities, counties, school districts and other local agencies to invest funds through the Treasurer's Office. As of December 31, 2003, the LAIF had \$22.3 billion under management. The PMIA's positive earnings record led to voluntary increased investment by local entities of more than \$700 million in 2003 – an expression of confidence in the Treasurer's money management.

TREASURER'S STRATEGIC DEBT MANAGEMENT PLAN RESULTS IN NEAR-TERM SAVINGS OF \$2.1 BILLION FOR TAXPAYERS

In January 2002, the Treasurer announced a Strategic Debt Management Plan to provide savings for taxpayers and reduce debt payments in both the short term and the long term. The plan has resulted in short term savings for taxpayers of \$2.1 billion. Implementation of the plan was completed in 2003.

The plan included refinancing existing bonds, taking advantage of historically low interest rates; the structuring of future bond sales with level annual debt service; and the sale of variable rate bonds, which carry lower interest rates

SPURRED FINANCIAL INSTITUTIONS TO WAIVE FEES FOR HOLOCAUST SURVIVORS

In July 2003, Treasurer Angelides joined with Bet Tzedek Legal Services in Los Angeles to ask the chief executive officers of more than 170 of California's financial institutions to sign a pledge to voluntarily waive any wire transfer or processing fees associated with Holocaust reparations or restitution payments. These fees, which can range from \$10 to \$40, can be a true burden on recipients, the vast majority of whom are elderly. An estimated 6,000 to 8,000 Californians receive Holocaust reparations or restitution payments, and Bet Tzedek estimates that 40 percent of those who receive payments live in poverty.

As of December 2003, more than 130 of the State's largest financial institutions – including banks, credit unions, savings and loans and broker/dealers – had agreed to waive these fees.

More information on Treasurer Angelides' efforts to assist Holocaust survivors and their families is available online at www.treasurer.ca.gov/holocaust.

FINANCING CALIFORNIA SCHOOLS AND INFRASTRUCTURE

LED COALITION TO PROTECT SCHOOLS FROM DEVASTATING BUDGET CUTS

Treasurer Angelides launched a statewide effort to save California's schools from devastating cuts proposed for the FY 2003-04 budget, bringing together a coalition of parents, teachers, students, and education officials to fight the proposals. The Treasurer called on the Governor and legislative leaders to ensure that the State meet its core responsibility of educating California's children, and protect investments in education that ensure an educated workforce critical to the State's economic strength in the decades ahead. The resulting budget passed by the Legislature and signed by Governor Davis restored funding for educational programs that had been initially proposed to be cut.

PROPOSED THREE-PRONGED PLAN TO STRENGTHEN CALIFORNIA'S ELECTRIC TRANSMISSION GRID FOR THE 21ST CENTURY

In November 2003, Treasurer Angelides unveiled a three-pronged proposal aimed at ensuring that the State has a reliable, ample 21st Century electric grid to meet California's economic and energy needs. The proposal, unveiled in the wake of massive August blackouts that plunged the Northeast into darkness, called on the California Energy Commission to adopt a comprehensive energy transmission plan that identifies needed renovations and additions to the State's transmission grid; authorized the California Consumer Power and Conservation Financing Authority, the state's Power Authority, to provide financing for improvements and additions to the State's transmission system; and called on the State to provide seed money to jump-start critically needed projects.

CHARTER SCHOOLS FACILITY PROGRAM FUNDS AWARDED

In 2003, the California School Facilities Authority (CSFA), chaired by Treasurer Angelides, and the State Allocation Board, made the first funding awards from

the State's Charter Schools Facility Program, awarding \$97 million in grants and loans to six California charter schools. Under the program, CSFA must determine that participating charter schools are financially sound.

In 2002, Treasurer Angelides was the first statewide elected official to call for the Legislature to approve a \$25 billion bond authorization to relieve school overcrowding and to repair older schools. As part of the Kindergarten-University Public Education Facilities Bond Acts of 2002 and 2004, the Treasurer spearheaded the carve-out of \$400 million for public charter school expansion and construction. In November 2002, voters approved the initial \$13.05 billion of a \$25.35 billion bond package, of which \$100 million was approved for the charter school facilities program. Voters in March 2004 approved the second, \$12.3 billion piece of the bond act, which includes the remaining \$300 million for charter school facilities.

More information on the Charter Schools Facility Program is available online at www.treasurer.ca.gov/csfa.

SCHOLARSHARE SAVINGS NEAR \$1 BILLION

The Golden State ScholarShare College Savings Trust, California's tax-advantaged college savings plan, saw continued growth in 2003, with assets invested reaching nearly \$950 million by year's end, up from \$525 million at the end of 2002. Participation in the program also grew significantly over the year, rising from 76,052 participants in 2002 to 116,107 by the end of 2003.

The ScholarShare program, launched by Treasurer Angelides in October 1999, is administered by the ScholarShare Investment Board, which the Treasurer chairs.

More information on California's Golden State ScholarShare College Savings Trust is available online at www.scholarshare.com.

EXTRA CREDIT PROGRAM HAS HELPED HUNDREDS OF CALIFORNIA TEACHERS PURCHASE HOMES

The Treasurer's Extra Credit Teacher Home Purchase Program is designed to attract and retain qualified teachers and principals to serve in low-performing schools. The program provides low-interest home loans or tax credits, coupled with down-payment assistance, for credentialed teachers and other designated school personnel who make a three-year commitment to help improve a low-performing school. By the end of 2003, the program had provided approximately 850 families with assistance in purchasing a home.

The Extra Credit Program is administered by the California Debt Limit Allocation Committee, chaired by the Treasurer. *More information on the Extra Credit Program is available online at www.treasurer.ca.gov/cdlac.*

INVESTING IN CALIFORNIA COMMUNITIES

CONTINUED PROGRESS ON DOUBLE BOTTOM LINE INITIATIVES

In 2003, sustained progress was made in implementing the Treasurer's *Double Bottom Line: Investing in California's Emerging Markets* initiative. By the end of

2003, this initiative had directed more than \$14 billion in investment capital to spur economic progress in California's inner cities and underserved communities. Capital investment has been made available for home mortgages, infill development, and business expansion – all with the “double bottom line” goals of solid returns for the State's pension and investment funds and broadened economic opportunity in California communities.

Investment highlights include:

- The PMIA, managed by the State Treasurer, has increased deposits in California community lending institutions, including banks and credit unions, by \$3.7 billion since January 1999. As of December 31, 2003, the PMIA had \$5.8 billion on deposit with 107 community lenders.
- The PMIA has invested \$1.7 billion in Community Reinvestment Act home mortgages – loans made in low- and moderate-income California neighborhoods or to low- and moderate-income Californians – since January 1999.
- CalPERS and CalSTRS have upped their investment allocations to urban, inner-city real estate ventures to over \$2 billion, including \$300 million for affordable housing.
- CalPERS and CalSTRS have now allocated over \$800 million for private equity investment to expand business opportunities in the underserved rural and urban communities of California.

Initial returns on *Double Bottom Line* programs have been positive. For example, the PMIA's investments in CRA home mortgages are currently yielding 5.88 percent annually. As another example, CalPERS' longest standing urban investment partnership has achieved an annualized return of 10.3 percent since inception.

More information on the Treasurer's Double Bottom Line initiatives is available online at <http://www.treasurer.ca.gov/publications/doublebottomline/DBL.htm>.

CALCAP PROGRAM EXPANDS SMALL BUSINESS LENDING

Under Treasurer Angelides' leadership, the California Capital Access (CalCAP) Program continued to expand its lending to California's small businesses in 2003. During the year, 588 loans were made totaling over \$70 million, creating or preserving 2,567 jobs. Since January 1999, CalCAP has made 2,069 in loans totaling \$480,206,949, which have helped to create or preserve 14,033 jobs. During Treasurer Angelides' tenure, the number of lenders participating in the CalCAP program has tripled. These loans provide the needed seed capital to launch and expand the small business enterprises critical to California's economic growth.

Since taking office, Treasurer Angelides has made a particular effort to expand the number of “microloans” – loans as small as \$500 and generally less than \$40,000 – that CalCAP makes available to the State's small businesses. The number of microloans has

increased from 18 in 2000 to 325 in 2003. When the Treasurer took office, 7.2 percent of CalCAP's lending was in the form of microloans; by 2003 microloans made up more than half of the program's lending.

The CalCAP program represents a success in the Treasurer's efforts to expand economic opportunity to underserved communities. In 2003, more than 60 percent of the program's loans were made to women/minority-owned businesses, among those lenders collecting and reporting such statistics. The CalCAP program is administered by the California Pollution Control Financing Authority, chaired by the Treasurer.

More information on the CalCAP program is available online at www.treasurer.ca.gov/cpcf.

CHFFA HELPS EXPAND HEALTH CARE ACCESS

Recognizing the tremendous need for healthcare in underserved communities, and the difficulties community clinics face in accessing needed capital, the Treasurer has put an emphasis on expanding financing to community health clinics. As Chair of the California Health Facilities Financing Authority (CHFFA), Treasurer Angelides continued in 2003 to provide these clinics access to the capital markets through bond financing, the HELP II program, the HealthCAP program, and grants from the Cedillo-Alarcón Community Clinic Investment Act of 2000. Highlights of CHFFA's 2003 activities include:

- Bonds issued through the authority provide tax-exempt capital to qualified non-profit health facilities throughout the State. In 2003, CHFFA issued bonds totaling \$718 million, an increase from the \$241 million issued in 2002.
- The HELP II program provides low-cost loans to assist small and rural health facilities with their capital needs. In 2003, CHFFA made 22 HELP II loans totaling \$8.03 million to community health facilities. These loans assisted facilities that provided over 698,000 annual visits to vulnerable Californians seeking healthcare services.
- The HealthCAP program, a partnership between CHFFA and NCB Development Corporation, assists health facilities, which have had difficulty obtaining adequate financing for their needs, access the capital markets. In 2003, HealthCAP closed 10 loans totaling \$9.01 million.
- CHFFA continued allocating funds under the Cedillo-Alarcón Community Clinic Investment Act of 2000, disbursing \$3.8 million in 2003. The grants disbursed in 2003 allowed community clinics to leverage \$18.1 million in additional capital investment. Since 2001, \$51.1 million has been allocated to 301 community clinics within the State, with at least partial funding to every eligible applicant under the program. Cedillo-Alarcón grant funding, coupled with other CHFFA financing, is expected to increase the capacity of these 301 clinics to enable an additional 577,000 additional annual patient visits.

More information on the Treasurer's healthcare facility financing programs is available at www.treasurer.ca.gov/chffa.

CIDFAC FINANCING HELPS MANUFACTURERS EXPAND, CREATE JOBS

The California Industrial Development Financing Advisory Commission's (CIDFAC) small business program helps the State's small manufacturing businesses grow by providing low-interest financing for capital expenditures including land acquisition, building construction or renovation and the purchase of equipment. In 2003 alone, this program offered \$3 million in financing for four projects and helped create 184 new jobs throughout the State.

More information on the CIDFAC small business program is available at:
www.treasurer.ca.gov/cidfac.